2010 INVESTMENT CLIMATE STATEMENT (ICS) MADAGASCAR

A.1 OVERVIEW OF FOREIGN INVESTMENT CLIMATE

2. The GOM (Government of Madagascar) officially welcomes foreign investment. However, the current political instability, following a March 2009 coup, has had a negative impact on foreign investment in the country. In 2009, only four foreign companies representing a total investment of USD 5 million invested in the country under the Export Processing Zone regime (EPZ). Overall foreign investment declined by 17 percent during the first three quarters of 2009 compared to that same time period in 2008. In addition to the political turmoil, factors such as a complex business environment, an unfair legal system, and high shipping costs are among the chief obstacles to foreign investment in the country. Large mining investments in the South and the East of Madagascar continue to move forward despite threats by the de facto Malagasy authorities (HAT) to review the contracts for those investments.

3. On May 19, the Millennium Challenge Corporation (MCC) Board decided to terminate the MCC program with Madagascar. Most donors, including the World Bank and the IMF, have suspended or frozen their funding, with the exception of humanitarian aid. On December 24, the U.S. Government determined that Madagascar no longer met the African Growth and Opportunity Act (AGOA) criteria regarding political pluralism and rule of law. Madagascar's suspension from AGOA could cause the closure of over 30 apparel firms and the lay-off of up to 50,000 workers.

4. Despite the temporary suspension of funding from the World Bank, the Economic Development Board of Madagascar (EDBM) continues to provide support to foreign investors.

5. Prior to the March coup, the Bretton Woods institutions had generally endorsed the government's macro-economic regime, although they questioned certain non-transparent budget and tax decisions in late 2008. During the latter three quarters of 2009, the de facto authorities maintained fiscal discipline and continued sound monetary policies, keeping inflation in check. Madagascar moved up 10 rankings in the World Bank 2010 Doing Business report, ranking 134 out of 181 countries compared to 144 in the 2009 report. The creation of the American Chamber of Commerce (AMCHAM) in late 2008 also benefited American and other investors by providing a new forum to lobby for their interests. However, better governance, including a return to constitutional rule, the improvement of the regulatory system and the fight against corruption, are urgent priorities. Since the beginning of the crisis, the Madagascar Action Plan (MAP), a five-year development strategy paper (2007-2011) has been suspended.

6. There is no law or regulation authorizing private firms to adopt

articles of incorporation or association that limit or prohibit foreign investment, participation or control. Further, there is no official practice to restrict foreign investment, participation in, or control of domestic enterprises. There is no mandatory screening of foreign investment and there is no discrimination against foreign investors at the time of the initial investment or after the investment is made, such as through special tax treatment, access to licenses, approvals, or procurement. To show transparency and good governance in the management of revenues from extractive resources, the GOM and the main operators in the extractive industries (e.g. Exxon Mobil, Rio Tinto, Madagascar Oil, and Sherritt) continued to take the necessary steps to implement the Extractive Industries Transparence Initiative (EITI) in 2009. Due to lack of financing, however, the international audit scheduled for 2009 to allow Madagascar to become a full member of EITI was not carried out. Hence, it is unlikely that the country will become a full member by March 2010 as previously projected.

A.2 CONVERSION AND TRANSFER POLICIES

7. In 1998, the GOM lifted all restrictions on current payment and transfers and accepted the obligations of Article VIII of the IMF articles of Agreement, which provides for the complete elimination of exchange controls. There are no restrictions on converting or transferring funds associated with foreign investment, including remittances of investment capital, earnings, loan repayments, and lease payments into a freely usable currency at legal market clearing rate. When delays occur in conversion or funds transfer, they are due to temporary shortages of foreign exchange. By law, foreign investors must make remittances through banks. There is no limitation on the inflow or outflow of funds for remittances of profits, debt service, capital, and returns on intellectual property. Exporters and foreign investors may maintain bank accounts in foreign currencies. Madagascar has a flexible exchange rate policy, allowing underlying exchange market pressures to determine rates and limiting central bank intervention to dampening temporary shocks and achieving its external reserves objectives.

8. In August 2009, Madagascar joined the Pan Africa e-network project which links 53 African countries by satellite or optical fiber. The project will benefit telemedicine, e-governance, and e-education services.

A.3. EXPROPRIATION AND COMPENSATION

9. There are no recent cases of expropriation actions by the GOM nor do Government policies suggest that it is likely to take such actions in the near future. The state divestiture from public enterprises has been a cornerstone of government policy. There are no laws requiring local ownership in specific economic sectors except in oil exploration, in which the Government office called OMNIS must be the partner of all foreign companies.

A.4. DISPUTE SETTLEMENT

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10. Madagascar's legal system is based on French civil law and its provisions contain adequate protections for private property rights. Malagasy commercial law consists largely of the Code of Commerce and Annexed laws, which are reportedly applied in a non-discriminatory manner. Madagascar has a written bankruptcy law, created in 1996 and currently included in the Code of Commerce. However, Madagascar ranked last in the World Bank's 2010 Doing Business Report in terms of closing a business due to the difficulties of bankruptcy and business closure procedures. The Malagasy judicial system is slow and complex and has a reputation of opacity and corruption. U.S. assistance has supported the development of alternative dispute resolution systems to provide more rapid, more transparent, and less costly resolution of commercial disputes.

11. Under the privatization law, the GOM accepts binding international arbitration of investment disputes between foreign investors and the state. The courts recognize and enforce foreign arbitral awards and international arbitration is accepted as a means for settling investment disputes between private parties. The Malagasy Arbitration and Mediation Center (CAMM, in its French acronym) was created in 2000 as a private organization to promote and facilitate the use of arbitration to resolve commercial disputes and to lessen reliance on a court system that is, at a minimum, overburdened. As a result, many private contracts now include arbitration clauses. The EDBM is also responsible for investment dispute resolution; however, it has been unable to resolve several concerns raised by American companies regarding conflicts of interest and the lack of transparency in contracting and in government regulatory decision making.

12. Madagascar is a signatory to the International Center for the Settlement of Investment Disputes (ICSID) Convention. Madagascar is also a signatory to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards and Madagascar has been a member of the Multilateral Investment Guarantee Agency (MIGA) since 1989.

A.5. PERFORMANCE REQUIREMENTS AND INCENTIVES
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13. As a signatory of the WTO Agreement, Madagascar is bound by the WTO TRIMS (Trade Related Investment Measures). Performance requirements are not imposed as conditions for establishing or maintaining investments, except in the Export Processing Zones (EPZ) regime under which firms must export 95 percent of output to qualify for EPZ investment incentives. Foreign or local investors can benefit from tax exemptions provided their EPZ projects fall into the following categories:
- Investment in export-oriented manufacturing industries;
- Development or management of industrial free zones; or
- Provision of services to EPZ companies.

14. The EPZ law approved in December 2007 granted the following advantages and tax incentives to EPZ companies:

- The EDBM is in charge of EPZ companies' approval. The EDBM has to
deliver an eligibility certificate within 20 days of deposit of file.
- 15 years tax exemption for EPZ companies
- No VAT or customs duties on imports of raw materials
- No registration taxes
- No customs tax on exported goods
- Income tax on expatriate not exceeding 30 percent of the taxable basis
- Free access to foreign currency deposited in the company's foreign
currency bank account.

15. The new export promotion law that was adopted in December 2008 determined that these EPZ provisions (advantages and tax incentives) would only be offered until December 2010. Already existing EPZ companies will continue to enjoy the advantages described above after that date.

16. There are no requirements restricting the mobility of foreign investors. The regime for visas, residence and work permits is, on its face, neither discriminatory nor excessively onerous. Since the creation of the EDBM, processing of residence and work permits has been streamlined.

17. There is no requirement that investors purchase from local sources, or export a certain percentage of output (except for EPZ companies), or only have access to foreign exchange in relation to their exports. There is no requirement that nationals own shares of foreign companies, that the share of foreign equity is reduced over time, or that technology is transferred on certain terms. There are no government-imposed conditions on permission to invest (although investors must apply for such permission), including location in a specific geographical area, specific percentage of local content or local equity, substitution for imports, export requirements or targets, employment of host country nationals, or technology transfer. Investors are not required to disclose proprietary information to the government as part of the regulatory approval process. U.S. and other foreign firms are able to participate in government-financed and/or subsidized research and development programs on a national treatment basis. There are officially no discriminatory or preferential export or import policies, which would affect foreign investors, nor discriminatory tariff or non-tariff barriers, or other measures such as import or price controls.

A.6. RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

18. Foreign and domestic private entities may establish and own business enterprises and engage in all forms of remunerative activity. They may freely establish, acquire, and dispose of interests in business enterprises. The government remains a minority shareholder in some privatized companies, such as in the Malagasy telecommunications company (Telma), and continues to own Air Madagascar, but competitive equality is the official standard

applied to all private enterprises with respect to access to markets, credit, and other business operations such as licenses and supplies. The USG and other donors had criticized ousted President Ravalomanana's use of position to unfairly benefit his company, TIKO Group. Since his departure, monopolies that were held by TIKO, for example on flour and vegetable oil, have been broken up, enabling increased - but very uneven - competition in those sectors.

A.7. PROTECTION OF PROPERTY RIGHTS

19. Secured interests in property are recognized, but not entirely enforced in the country. Banks and insurance companies use mortgages to guarantee loans relating to commercial property.

20. A prohibition on land ownership by foreigners impedes access to real property, and the entire issue remains highly controversial and problematic despite legal advances, for cultural reasons. A system of long-term leases - up to 99 years - was established in 2008 following the adoption of investment law 2007-036 to address the issue, but there have been long delays and few successes so far in the approval of land leases for foreigners. The new investment law grants land and properties to companies registered in Madagascar under certain conditions fixed by EDBM, which issues authorization documents. In addition, MCC's contribution to the land tenure issue somewhat improved the land rights process prior to early termination of the program in late 2009.

21. Madagascar is a member of the WIPO (World Intellectual Property Organization) and is a signatory to the WTO TRIPS agreement on trade related aspects of intellectual property. Two government offices share responsibility for the protection of intellectual property rights: the Malagasy Office for Industrial Property (OMAPI) and the Malagasy Copyright Office (OMDA). Protection of intellectual property rights is uneven. Officially, authorities protect against infringement, but in reality, enforcement capacity is quite limited. Major brands are generally respected but pirated copies of movie DVDs, music CDs and tapes, electronic equipment and spare parts are sold openly. Some television stations regularly show pirated copies of first-run U.S. and European movies. On July 17, 2006, an inter-ministerial decree was issued to reinforce measures to fight counterfeiting of literary and artistic works. Upon evidence of illegal activity, OMDA and its partners (police, customs officers, tax officers, controllers of the ministry of commerce) should seize all illegally reproduced recorded products, be they illegally manufactured or imported, and specific materials used for such dealings. Those products are subject to public destruction in presence of the contravener(s). A control committee was set up in 2004, and this committee is in charge of implementing the 2006 decree. In 2009, the committee conducted 26 operations and seized 25,000 counterfeit music CDs and movie DVDs. Despite these initiatives, overall enforcement of intellectual property rights remains limited due to a shortage of trained personnel, legal capacity and resources.

A.8. TRANSPARENCY OF REGULATORY SYSTEM

22. Excessively complex and inconsistently applied bureaucratic regulations are an impediment to investment and can be a breeding ground for corrupt practices. The lack of transparency in government regulatory decisions has generated complaints from current investors. For unknown reasons, two companies - a brewery and a mobile phone company - were refused licenses in 2009. Although regulatory decisions can impede start-up in particular industries, the normal business registration process has been streamlined by EDBM and generally takes less than two weeks now.

23. Tax, labor, environment, health, and safety standards are generally not used to impede foreign investment, and there are no informal regulatory processes managed by non-governmental organizations or private sector associations.

24. Accounting systems are transparent and consistent with international norms, and there are no private sector and/or government/authority efforts to restrict foreign participation in industry standard-setting consortia or organizations.

A.9. EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

25. In spite of the general under-development of the banking system, banks are free to support the flow of resources in the product and factors markets. Credit is usually allocated on market terms and the private sector/foreign investors are able to get credit on the local market. However, many of the EPZ companies use the services of banks in neighboring Mauritius, where the sector is more developed.

26. There are no cross-shareholding arrangements used by private firms to restrict foreign investment through mergers and acquisitions. There are no visible private sector and/or government efforts to restrict foreign participation in industry or control of domestic enterprises.

27. Within the Malagasy law, there is an effective regulatory system established to encourage and facilitate portfolio investment and the estimated total assets of the country's largest bank are around USD 400 million.

28. The creation of the Malagasy Bank for Construction and Development (BMCD) planned for 2009 by the ousted president was cancelled. A new bank BGFI (Banque Gabonaise et Frangaise Internationale) has just obtained an agreement and will be operational in 2010.

A.10. COMPETITION FROM STATE-OWNED ENTERPRISES (SOEs)

29. Private enterprises are allowed to compete with public enterprises under the same terms and conditions with respect to access to markets, credit, and other business operations, such as licenses and supplies. The main SOEs are the airline Malagasy Company (AIRMAD) and the Malagasy Water and Energy Company (JIRAMA). SOEs have boards of directors for which seats are specifically

allocated to senior government officials or politically-affiliated individuals.

30. A sovereign wealth fund (SWF) does not exist in the country.

31. SOEs are required by law to publish an annual report, and they are also required to submit their books to independent audit.

A.11. CORPORATE SOCIAL RESPONSIBILTY (CSR)

32. There is a lack of general awareness of corporate social responsibility among producers and consumers, but CSR principles are applied by several large, formal sector companies. Although those companies do not follow the OECD Guidelines for Multinational Enterprises, public opinion is favorable regarding those firms who pursue CSR.

A.12. POLITICAL VIOLENCE

33. During 2009, Madagascar experienced frequent political demonstrations that on occasion became violent. Opposition political meetings are frequently blocked by the administration, and security forces at times use excessive force, sometimes resulting in death or injury, to abrogate the rights of assembly and free speech.

34. Public safety is fairly adequate, although standard warnings to guard against street crime and theft from vehicles and to minimize or avoid nighttime road travel apply, particularly in rural areas. Madagascar, being an island, has no belligerent neighbors.

A.13. CORRUPTION

35. Complicated administrative procedures introduce delays, uncertainties and multiply the possibilities for corruption. Corruption is most pervasive in the following sectors: justice, police, tax, customs, land, trade, mining, industry, environment, education, and health.

36. Despite the existence of the Independent Anti-Corruption Bureau (BIANCO), corruption at high levels exists in nearly all sectors.

37. Smuggling of precious stones and hardwood is increasingly a drain on Madagascar's natural resources, and one that also breeds criminality. In early September, the GOM decided to create a special task force composed of different departments to combat hardwood smuggling, but shortly thereafter it temporarily authorized the export of illegally-felled hardwood to raise revenue, encouraging further pillaging of the forests.

38. Madagascar created a Financial Intelligence Unit (SAMIFIN) in mid-2008 to carry out research and financial analysis related to money laundering. Despite insufficient funding, SAMIFIN received 45 suspicious transaction reports in 2009 and referred 10 cases to the public prosecutors.

39. Giving or accepting a bribe is a criminal act and is sentenced by court.

40. In 2009, Transparency International ranked Madagascar 99th out of 180 countries surveyed, as it scored 3 on the Corruption Perception Index (CPI), indicating a severe corruption problem.

41. Madagascar has not yet signed the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

A.14. BILATERAL INVESTMENT AGREEMENTS

42. According to ICSID (International Center for the Settlement of Investment Disputes) and UNCTAD, Madagascar has concluded bilateral investment agreements with Switzerland, Sweden, Norway, Mauritius, Germany, France, Thailand, Belgium, China, and Canada. Also, Madagascar has signed double taxation treaties with France and Mauritius. The Malagasy government had expressed interest in negotiating a bilateral investment treaty with the U.S. Initial discussions began in late 2008, but stalled due to the unconstitutional change of government in March 2009.

A.15. OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

43. On March 31, 1998, OPIC and Madagascar signed a bilateral Investment Incentive Agreement, which updates the old agreement of 1963.

44. Madagascar is a member of the MIGA (Multilateral Investment Guarantee Agency). The average annual exchange rate for 2009 was 1956 ariary per one USD. As of January 2010, the ariary had depreciated to around 1974 per one USD. To the benefit of Malagasy exporters, further depreciation is expected in 2010.

A.16. LABOR

45. Madagascar has a significant pool of available labor, due to the combined impact of unemployment and under-employment. Private sector wages have been relatively stable and are below those in most competitor countries; indeed, this fact, combined with the high quality of much Malagasy labor, may constitute the country's strongest asset for foreign investors. The minimum wage for the non-agricultural private sector in 2009 was 70,025 ariary per month, approximately USD 36. The Constitution and Labor Code grant workers in the private and public sectors the right to establish and join labor unions, and to bargain collectively. The National Labor Code and implementing legislation prescribe working conditions, wages, and standard for worksite safety. As a member of the ILO (International Labor Organization), Madagascar adheres to the ILO convention protecting workers rights.

A.18. FOREIGN TRADE ZONES/ FREE PORTS

46. The incentives available in the Export Processing Zone (EPZ) are described in "Performance Requirements and Incentives". There is no distinction between foreign and domestically owned firms in terms of eligibility for EPZ treatment, which has been granted by the EDBM since December 2007. Again, as stated earlier, EPZ incentives will be offered only through December 2010, but pre-existing EPZ firms will maintain their incentives and status beyond that date.

A.19. FOREIGN DIRECT INVESTMENT STATISTICS

47. According to a World Bank survey, Madagascar is among the 50 most difficult countries in the world in which to conduct business. The main reasons are the weaknesses of the judicial system and the banking system (high interest rates and unavailability of credit), the high cost and low quality of electric power, high tax rates, red tape, corruption, a lack of transparency in decision-making, and the high costs of ground and air transport.

48. According to Central Bank figures, in 2008, FDI inflows to Madagascar amounted to USD 1.12 billion, or 11.8 percent of GDP compared to 10.5 percent in 2007. Despite an increase of 31 percent between 2007 and 2008, the actual FDI inflows in 2008 were 76 percent lower than previously projected. FDI flows were concentrated in the following sectors: extractive industry (USD 958.5 Million or 85.5 percent), telecommunication (USD 86.5 Million or 7.71 percent) and vehicle trading (USD 24.8 Million or 2.22 percent). The main countries of origin of FDI inflows were respectively: United Kingdom (USD 563.3 Million or 50.3 percent), Canada (USD 260.6 Million or 23.2 percent), Bahrain (USD 71.2 Milion or 6.4 percent), Japan (USD 62.2 Million) and South Korea (USD 57.6 Million or 5.1 percent). Bahraini investments were concentrated in the telecommunication sector with Life investing in the mobile telephony sector. Life plans to become the fourth mobile operator in the country, but is not yet operational due to a dispute regarding its license.

49. Central Bank statistics indicate that total FDI stock amounted to USD 3.12 billion in 2008 compared to USD 1.99 billion in 2007, an increase of 56 percent. Between 2005 and 2008, FDI stock increased tenfold due to investment in the extractive industry triggered mainly by the ilmenite investment project of QIT Madagascar Mineral (Rio Tinto) and by the nickel and cobalt investment project of Ambatovy, a joint venture including Sherritt International, SNC-Lavalin, Sumitomo Corporation and Korea Resources Corporation. FDI stock in the extractive industry represented 73 percent of the total, followed by building and public works (5.6 percent), telecommunication (4.4 percent), and financial services (3.9 percent).

50. FDI flows from the US amounted to USD 12.9 million in 2008 which represents 1.15 percent of the total. If one considers only non-extractive industry FDI, the US represents 7.95 percent of the total. U.S. investment covers a broad spectrum of sectors including oil exploration, apparel, mining, and handicrafts.

51. During the first three quarters of 2009, FDI inflows to the country amounted to USD 954 million, mainly to support pre-existing mining projects. This represents a 17 percent decrease from the same time period in 2008, during which FDI amounted to USD 1.15 billion. Most potential private investors have put new projects on hold pending greater political stability. Foreign donors have suspended most of the external financing which represented nearly 70 percent of the government's investment expenditure, thus public investment projects are stalled as well. Once the political situation stabilizes, several additional large mining projects, particularly in coal and bauxite, are expected to be developed. In the long term, the agribusiness sector has the potential to attract sizable, job-generating investments, particularly in palm oil, corn and sugar, but land tenure complications have deterred such investments to date. Tourism also has the potential to attract foreign investment, but the industry has also been hampered by the political crisis which has reduced the number of visitors to the island.

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